



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

State Capitol
Nashville, Tennessee 37243-9034
(615) 741-2501

Justin P. Wilson
Comptroller


April 7, 2010


Memorandum


TO: Governor Phil Bredesen


Chairman Randy McNally
Senate Finance, Ways, & Means Committee

Chairman Craig Fitzhugh
House Finance, Ways, & Means Committee

FROM: Justin P. Wilson, Comptroller of the Treasury 

Tre Hargett, Secretary of State 

David H. Lillard Jr., State Treasurer 

M.D. Goetz, Jr., Commissioner
Department of Finance & Administration 

SUBJECT: Revenue Estimates for FY 2009-10 and FY 2010-11

The State Funding Board met on March 19 and 24, 2010, to hear updated revenue estimating presentations on the State's near-term economic outlook for the fiscal years 2009-10 and 2010-11. The Board also heard presentations from several additional experts on March 24 and 25, 2010. These presentations provided additional insight on both the state and national economy, but did not include specific revenue projections. The Board reconvened on March 25 and 29, 2010, to discuss the revenue projections and to arrive at consensus estimates.

Total State Taxes and General Fund Revenue Estimates

The Board is charged, in Tennessee Code Annotated Section 9-4-5202(e), with the responsibility of developing consensus ranges of state revenue growth. In doing so, the

Board evaluates and interprets economic data and revenue forecasts supplied by various economists as well as persons acquainted with the Tennessee revenue system. This is a revenue estimation process and not a budgeting process. The Board does not take into consideration the State's fiscal situation when developing its consensus ranges of revenue growth; however, the Board does strive to have the highest degree of confidence in the State's ability to achieve such growth. Fiscal considerations properly belong with those who set the State's budget - the Administration that recommends appropriation levels based upon its assessment of revenue growth and the General Assembly that adopts a *de facto* revenue estimate through its final action on the appropriations bill.

The Board heard testimony regarding the economy from Dr. William Fox of The University of Tennessee; Dr. Albert DePrince of Middle Tennessee State University; Mr. Jim White, Mr. Dan Cooper, and Mr. Robert Currey of the Fiscal Review Committee; and Commissioner Reagan Farr and Mr. Zhijie "Jack" Qi of the State Department of Revenue. The state tax revenue estimates provided by each of the presenters are summarized in two attachments to this memorandum.

The Board additionally heard commentary from Dr. Arthur Laffer, CEO of Laffer Associates; Mr. Lee Jones, Regional Executive with the Federal Reserve Bank of Atlanta; and Dr. Keith Absher, Dean and Professor of Business Administration, Union University. It should be noted that these commentators did not provide specific revenue estimates, but provided their insights on the national and state economies.

The consensus of the presenters and commentators is that the economy both nationally and in Tennessee is slowly beginning to show signs of emerging from the worst economic downturn since the Great Depression. The presenters and commentators acknowledged that just as this economic downturn has been unprecedented, the economic recovery will likewise be unprecedented. Growth in the national and state economies is expected to remain weak through fiscal year 2010-2011.

It was noted that the Tennessee economy as a microcosm of the larger U.S. economy tends to track the nation's economy. State economies, including Tennessee's, are unlikely to show any significant signs of improvement until the nation's economy improves. It was further noted that states without an income tax have fared better and are more strategically positioned for a quicker recovery than those states with a state income tax.

The unemployment rate and the lack of housing starts were identified as the major contributors to Tennessee's current economic condition. The unemployment rate in Tennessee continues to exceed that of the national average, currently higher by one percent (1%). There are signs that the unemployment rate is beginning to stabilize, but positive growth in employment is expected to occur slowly. New housing starts are experiencing negative growth and are not anticipated to experience positive growth until 2011. Several of the presenters and commentators noted that until such time as the

unemployment rate and housing starts improve, Tennessee's economy is not likely to experience any appreciable improvement.

Consumer confidence remains low in Tennessee due in part to the high unemployment level. This lack of consumer confidence continues to impact Tennessee's current economic condition. While consumer confidence has shown signs of strengthening, it remains unclear whether it will translate into increased discretionary spending. Consumer confidence is "spotty" and may be subject to short false starts. In recent months the consumer savings rate has declined, but it remains at historically high levels. Several presenters indicated that the savings rate is likely to remain at its current level or possibly increase over the next fiscal year.

Sales of light vehicles continue to improve, but this improvement appears to be the result of consumers purchasing out of necessity. The housing market continues to experience decline. Credit constraints continue to adversely affect both the housing and vehicle sales markets. Banks are experiencing tremendous pressure to ensure that borrowers are credit worthy and as a result, fewer loans are being made. Conversely, economic uncertainty may be a contributing factor driving down demand for credit by small businesses who have found ways to operate more efficiently with fewer resources.

Various aspects of stimulus projects have been and will continue to be subject to Tennessee taxes. While the revenues generated from the federal stimulus package have had a positive impact on Tennessee's economy, this impact is expected to be short-lived. As the benefits of the stimulus package come to an end in December 2010 and with the expiration of the Bush Administration tax cuts on December 31, 2010, there is concern about the sustainability of any growth in the economy into the first half of calendar year 2011.

Since December 2009 when the last growth estimates were made, the Tennessee economy has continued to decline. The Board developed the following summarized consensus estimates expressed in ranges of growth rates in State tax revenue collections.

	FY 2009-10		FY 2010-11	
	Low	High	Low	High
Total State Taxes	-1.77%	-1.29%	1.73%	1.98%
General Fund Only	-2.31%	-1.78%	2.05%	2.30%

While it is difficult to precisely predict revenue ranges due to the uncertainty regarding anticipated economic recovery, the Board believes that these ranges are reasonable and appropriate for use in State budgeting. These ranges are based on statutory tax provisions enacted through the 2009 session of the General Assembly. The higher estimates assume positive growth in the economy in the last half of calendar year 2010.

Net Lottery Proceeds Revenue Estimates and Long-Term Funding Needs Estimates

The State Funding Board also received presentations regarding the Tennessee Education Lottery (TEL). Legislation in 2003 created the Tennessee Education Lottery Corporation (TELC) (Tennessee Code Annotated Sections 4-51-101 et seq.) Tennessee Code Annotated Section 4-51-111(c) requires the Board to establish a projected revenue range for the “Net Lottery Proceeds” [defined in Section 4-51-102(14)] for the remainder of the current fiscal year and for the four succeeding fiscal years.

Mr. Robert Currey, Chief Economist with the Fiscal Review Committee (FRC) presented to the Board the FRC’s lottery projections. Mr. Currey reviewed his December estimates. He observed that instant ticket sales during the holiday season were better than expected. The new instant ticket game (Millionaire Jumbo Bucks) was introduced on February 1, 2010, and has generated more incremental sales than expected. Expected cannibalization of both Pick 5 and Powerball due to the Mega Millions launch has not occurred. He cautioned that there was not sufficient history with this game to be able to forecast whether the cannibalization will occur or not. Mr. Currey revised his estimated forecast for fiscal year 2009-10, to reflect slight growth in Net Lottery Proceeds. However, he lowered his estimate of Net Lottery Proceeds available for deposit into the Lottery Education Account for fiscal years 2009-10 and 2010-11 to 25.6% and 25.4%, respectively. Due to the high level of uncertainty, Mr. Currey projected Net Lottery Proceeds and after-school funding for fiscal year 2011-12 through fiscal year 2013-14 to be fixed at the estimates for fiscal year 2010-11.

Ms. Rebecca Hargrove, Chief Executive Officer, and Mr. Andy Davis, Chief Financial and Technology Officer, both of the TELC, also presented their estimate of total and Net Lottery Proceeds for the current fiscal year and four succeeding fiscal years. TELC also projected slight growth in Net Lottery Proceeds for fiscal year 2009-10 and modest growth in Net Lottery Proceeds for fiscal year 2010-11 through 2013-14. Ms. Hargrove reviewed significant factors impacting TELC estimates. She commented that profits have increased by \$4.4 million from this time last year. This increase is due to the growth in higher price point games, the introduction of Mega Millions, and the increased sale of Powerball tickets. Ms. Hargrove also commented on the relationship between the prize payouts and net lottery proceeds, acknowledging that the percentage of prize payout continues to increase, while the percentage of net lottery proceeds continues to decrease. However, she cautioned that a decrease in prize payout would negatively impact sales.

Tennessee Code Annotated Section 4-51-111(c)(2)(A)(ii) requires the Board with the assistance of the Tennessee Student Assistance Corporation (TSAC) to project long-term funding needs of the lottery scholarship and grant programs. These projections are to be done to determine if adjustments to lottery scholarship and grant programs are needed to prevent the funding for these programs from exceeding Net Lottery Proceeds. For this purpose, the Board heard from Mr. David L. Wright, Assistant Director for Policy Planning and Research of the Tennessee Higher Education Commission (THEC), and

from Mr. Tim Phelps, Associate Executive Director for Grants and Scholarship Programs of TSAC.

They affirmed the December 2009 projections for fiscal year 2009-10, which estimates there will be 101,300 awards, with a projected cost of \$287.5 million. Furthermore, Mr. Wright presented estimates for fiscal year 2010-11 of 113,000 awards, with a projected cost of \$312.5 million. Additionally, it is estimated that there will be 125,350 awards in fiscal year 2011-12, with a projected cost of \$337.4 million, 138,650 awards in fiscal year 2012-13, with projected cost of \$361.4 million, and 154,000 awards in 2013-14, with a projected cost of \$387.9 million. These awards include all lottery-funded scholarship programs as authorized through the 2009 session of the General Assembly, including Hope Scholarship, General Assembly Merit Scholarship, ASPIRE Award, HOPE Access Grant, Wilder-Naifeh Technical Skills Grant, Nontraditional Student Grant, Foster Child Tuition Grant, Dual Enrollment Grant, Math & Science Teacher Loan Forgiveness Program, Helping Heroes Grant, the Rural Health Loan Forgiveness Program and Tennessee Student Assistance Award.

Based upon these projections, substantive changes to the lottery scholarship and grant programs are necessary to prevent the awards for these programs from exceeding Net Lottery Proceeds.

The estimates provided by each of the presenters are summarized in an attachment to this memorandum. Consensus was reached on the following estimates of the range for Net Lottery Proceeds to be deposited in the Lottery for Education Account and used for the various statutory purposes:

Net Lottery Proceeds	FY2009-10	FY2010-11	FY2011-12	FY2012-13	FY2013-14
Low	\$262,100,000	\$260,800,000	\$259,500,000	\$258,200,000	\$256,900,000
High	\$272,000,000	\$274,700,000	\$277,400,000	\$280,200,000	\$283,000,000

The State Funding Board considered the joint projections for lottery scholarship and grant program funding needs provided by TSAC and THEC and accepted their recommended projections. The following is a comparison of the mid-point of the estimated range of Net Lottery Proceeds and the projected scholarship and grant funding needs:

	FY2009-10	FY2010-11	FY2011-12	FY2012-13	FY2013-14
Net Lottery Proceeds (Mid-point of Range)	\$267,050,000	\$267,750,000	\$268,450,000	\$269,200,000	\$269,950,000
Scholarship and Grant Funding Needs	\$287,500,000	\$312,500,000	\$337,400,000	\$361,400,000	\$387,900,000
Deficit	(\$20,450,000)	(\$44,750,000)	(\$68,950,000)	(\$92,200,000)	(\$117,950,000)

These estimates and projections assume no new legislative changes regarding the TELC and its authority or to the scholarship and grant programs. The Board agreed with the presenters that Net Lottery Proceeds are difficult to project. The Board noted that for fiscal year 2009-10 the revised projected current revenues¹ of the Lottery for Education Account are less than the revised appropriation requirements²; however funds are available in the unobligated reserve.³ The Funding Board expressed concern about the sustainability of the lottery scholarship programs as currently structured.

Each of us stands ready to discuss this further at your convenience.

Attachments

Revenue Estimates (2)
Lottery Estimates
TSAC/THEC Report

cc. The Honorable Ron Ramsey
The Honorable Kent Williams

¹ Revenues are Net Lottery Proceeds (a mid-point of \$267.05 million) and interest earnings (\$17.3 million).

² Appropriation requirements are higher education scholarship programs (\$287.5 million), Pre-Kindergarten (\$3 million) and administration (\$4.1 million).

³ Based on the appropriation requirements, this will require utilization of \$10.25 million from the reserve. Utilizing the reserve reduces future interest earnings; based on the projections it appears that in fiscal year 2013-14 the reserve amount and interest earnings will not be sufficient to fund the deficit.

Page 1

[illegible]

Budgeted Est. Compared to March Est. - Total

SELECTED TAXES	ACTUAL		BUDGETED		BUDGET		DR. FOX		FISCAL REVIEW		REVENUE DEPT.		DR. DEPRINCE	
		%		%		%		%		%		%		%
SALES AND USE TAX	\$ 6,320,798.300	1.58%	\$ 6,414,300.000	-1.48%	\$ 6,207,000.000	-1.80%	\$ 6,100,000.000	-3.49%	\$ 6,143,000.000	-3.02%	\$ 6,130,100.000	-3.02%	\$ 6,154,400.000	-1.43%
FRANCHISE AND EXCISE TAXES	1,361,796.800	1.59%	1,340,300.000	1.58%	1,415,300.000	3.93%	1,425,000.000	4.64%	1,342,495.000	6.00%	1,342,300.000	3.61%	1,361,400.000	-2.63%
INCOME TAX	220,449.800	-14.72%	188,000.000	-14.72%	190,000.000	-13.81%	178,000.000	-19.26%	187,000.000	-16.08%	179,500.000	-18.58%	193,600.000	-12.18%
ROAD USER TAXES	1,086,690.400	2.57%	1,083,900.000	2.57%	1,077,400.000	1.98%	1,059,500.000	1.98%	1,050,300.000	1.29%	1,051,900.000	0.50%	1,051,100.000	-0.53%
ALL OTHER TAXES	1,193,804.700	5.17%	1,254,800.000	5.17%	1,230,300.000	3.06%	1,211,200.000	1.66%	1,219,709.000	2.17%	1,229,911.000	3.86%	1,271,200.000	6.48%

- (1) F&A calculated the General Fund distribution for all presenters.
- (2) Privilege Tax estimates are reduced by \$10.7 million for the earmarked portion of the tax.

* F&A distributed taxes for Dr. DePrince based on ratios for the 2009-2010 Budget Document Revised Estimate
 ** F&A distributed the Gross Receipts Taxes for Dr. DePrince based on anticipated 2009-2010 TVA collections.

COMPARISON OF ESTIMATED STATE TAX REVENUE
FISCAL YEAR 2010-2011
(Actual - Basis Estimates)

ESTIMATES SUBJECT TO CHANGE

2010-2011									
DEPARTMENT OF REVENUE									
SOURCE OF REVENUE	BUDGET DOCUMENT ESTIMATE	% CHANGE OVER 09-10 ESTIMATE	DR. FOX ESTIMATE	% CHANGE OVER 09-10 ESTIMATE	FISCAL REVIEW ESTIMATE	% CHANGE OVER 09-10 ESTIMATE	REVENUE DEPT. ESTIMATE	% CHANGE OVER 09-10 ESTIMATE	DR. DEPRINCE ESTIMATE
Sales and use Tax	\$ 6,300,100,000	1.50%	\$ 6,252,500,000	2.50%	\$ 6,252,600,000	2.00%	\$ 6,268,500,000	2.26%	\$ 6,292,100,000
Gasoline Tax	625,200,000	1.49%	604,000,000	0.00%	623,210,000	1.50%	616,300,000	1.09%	610,600,000
Motor Fuel Tax	156,800,000	2.48%	152,400,000	2.97%	155,288,000	2.50%	156,200,000	4.55%	141,700,000
Gasoline Inspection Tax	64,700,000	2.05%	62,700,000	1.95%	64,056,000	2.00%	62,400,000	0.71%	72,200,000
Motor Vehicle Registration Tax	252,400,000	3.02%	253,400,000	3.01%	249,260,000	3.00%	245,500,000	3.57%	244,000,000
Income Tax	199,500,000	5.00%	188,700,000	6.01%	194,250,000	5.00%	185,900,000	1.91%	195,400,000
Privilege Tax - Less Earmarked Portion	226,000,000	-1.74%	222,600,000	4.02%	229,500,000	2.00%	230,400,000	-1.12%	243,800,000
Gross Receipts Tax - TVA	321,000,000	1.01%	324,300,000	2.01%	321,088,000	1.00%	299,080,000	-5.94%	310,700,000
Gross Receipts Tax - Other	23,800,000	4.89%	22,400,000	1.82%	23,625,000	5.00%	22,155,000	1.84%	22,900,000
Beer Tax	18,100,000	2.26%	17,700,000	2.31%	17,938,000	2.50%	18,017,000	2.04%	20,200,000
Alcoholic Beverage Tax	45,900,000	2.46%	48,500,000	4.30%	46,535,000	2.50%	47,550,000	2.59%	51,200,000
Franchise & Excise Taxes	1,487,400,000	5.09%	1,453,500,000	2.00%	1,472,365,000	2.00%	1,454,600,000	3.10%	1,362,800,000
Inheritance and Estate Tax	82,400,000	3.00%	84,000,000	0.00%	84,354,000	2.00%	86,330,000	0.36%	91,900,000
Tobacco Tax	301,500,000	0.50%	297,800,000	1.99%	290,000,000	0.00%	297,400,000	0.36%	336,400,000
Motor Vehicle Title Fees	10,300,000	3.00%	10,300,000	0.98%	10,250,000	2.00%	10,570,000	2.17%	11,500,000
Mixed Drink Tax	54,500,000	2.06%	57,800,000	5.09%	55,998,000	2.00%	55,980,000	1.73%	60,800,000
Business Tax	157,900,000	3.00%	157,500,000	5.00%	157,899,000	3.00%	156,190,000	1.62%	176,200,000
Severance Tax	2,300,000	4.55%	2,000,000	0.00%	2,266,000	3.00%	2,200,000	4.76%	2,600,000
Coin Operated Amusement Tax	300,000	0.00%	300,000	0.00%	300,000	0.00%	300,000	0.00%	300,000
Unauthorized Substance Tax	-	NA	-	NA	-	NA	-	NA	-
TOTAL DEPARTMENT OF REVENUE	\$ 10,330,000,000	2.08%	\$ 10,212,400,000	2.39%	\$ 10,250,782,000	2.01%	\$ 10,215,572,000	1.93%	\$ 10,247,400,000
GENERAL FUND ONLY (1)	\$ 8,440,100,000	2.25%	\$ 8,351,500,000	2.69%	\$ 8,371,182,000	2.16%	\$ 8,359,872,000	2.25%	\$ 8,392,100,000
Change over FY 10 Budgeted Est. - Total	\$ 48,700,000		\$ (68,900,000)		\$ (30,518,000)		\$ (65,728,000)		\$ (33,900,000)
Change over FY 10 Budgeted Est. - GF	\$ 32,900,000		\$ (55,700,000)		\$ (36,018,000)		\$ (47,328,000)		\$ (15,100,000)
Budget Document Compared to March Est. - Total			\$ (117,600,000)		\$ (79,218,000)		\$ (114,428,000)		\$ (82,600,000)
Budget Document Compared to March Est. - GF			\$ (88,600,000)		\$ (68,918,000)		\$ (80,228,000)		\$ (48,000,000)

SALES AND USE TAX DOCUMENT % DR. FOX % FISCAL REVIEW % REVENUE DEPT. % DR. DEPRINCE %

FRANCHISE AND EXCISE TAXES \$ 6,300,100,000 1.50% \$ 6,252,500,000 2.50% \$ 6,252,600,000 2.00% \$ 6,268,500,000 2.26% \$ 6,292,100,000 2.24%

INCOME TAX 1,487,400,000 5.10% 1,453,500,000 2.00% 1,472,365,000 2.00% 1,454,600,000 3.10% 1,362,800,000 1.53%

ROAD USER TAXES 199,500,000 5.00% 188,700,000 6.01% 194,250,000 5.00% 185,900,000 3.57% 195,400,000 0.93%

ALL OTHER TAXES 1,099,100,000 2.01% 1,072,500,000 1.23% 1,091,814,000 2.01% 1,080,400,000 1.74% 1,068,500,000 1.66%

1,243,900,000 1.11% 1,245,200,000 2.81% 1,239,753,000 1.64% 1,226,172,000 -1.11% 1,328,500,000 4.51%

(1) F&A calculated the General Fund distribution for all presenters.

(2) Privilege Tax estimates are reduced by \$10.7 million for the earmarked portion of the tax.

* F&A distributed taxes for Dr. DePrince based on ratios for the 2010-2011 Budget Document Estimate.

** F&A distributed the Gross Receipts Taxes for Dr. DePrince based on anticipated 2009-2010 TVA collections.

Net Lottery Proceeds Estimates
State Funding Board Staff Recommendation
Actual 2008-2009 and Estimated 2009-2010 Through 2013-2014
March 2010

	2008-2009	2009-2010	%	2010-2011	%	2011-2012	%	2012-2013	%	2013-2014	%
	Actual	Revised		Estimated		Estimated		Estimated		Estimated	
Lottery Corporation											
Low	265,486,000	262,102,000	-1.27%	268,000,000	2.25%	271,000,000	1.12%	274,000,000	1.11%	276,000,000	0.73%
High	265,486,000	272,420,000	2.61%	276,000,000	1.31%	279,000,000	1.09%	282,000,000	1.08%	284,000,000	0.71%
Mid-Range Estimate	265,486,000	267,300,000	0.68%	272,000,000	1.76%	275,000,000	1.10%	278,000,000	1.09%	280,000,000	0.72%
Fiscal Review Staff *											
Low	265,486,000	266,819,000	0.50%	268,784,000	0.74%						
Median	265,486,000	270,100,000	1.74%	271,911,000	0.67%						
High	265,486,000	273,377,000	2.97%	275,038,000	0.61%						
Recommended Range											
Low	265,486,000	262,100,000	-1.28%	260,800,000	-0.50%	259,500,000	-0.50%	258,200,000	-0.50%	256,900,000	-0.50%
High	265,486,000	272,000,000	2.45%	274,700,000	0.99%	277,400,000	0.98%	280,200,000	1.01%	283,000,000	1.00%

* Fiscal Review Staff does not project revenues for fiscal 2011-2012 through 2013-2014 and comments, "Due to high level uncertainty, projections for net lottery proceeds. . . for the three out-years remain fixed at FY 10-11 levels."



STATE OF TENNESSEE
TENNESSEE STUDENT ASSISTANCE CORPORATION
SUITE 1510, PARKWAY TOWERS
404 JAMES ROBERTSON PARKWAY
NASHVILLE, TENNESSEE 37243-0820
(615)741-1346 • 1-800-342-1663 • FAX (615)741-6101
www.TN.gov/collegepays

March 16, 2010

MEMORANDUM

TO: State Funding Board

FROM: David L. Wright, Tennessee Higher Education Commission
Tim Phelps, Tennessee Student Assistance Corporation

SUBJECT: Tennessee Education Lottery Scholarship Program Projections

Pursuant to T.C.A 4-51-111(c)(2)(A)(ii), the Tennessee Higher Education Commission (THEC) and Tennessee Student Assistance Corporation (TSAC) have collaborated to project expenditures in lottery and scholarship grant programs for the 2009-10 fiscal year and the next four fiscal years.

The figures below incorporate data for all lottery-funded programs, including the HOPE Scholarship, General Assembly Merit Scholarship, ASPIRE award, HOPE Access Grant, Wilder-Naifeh Technical Skills Grant, Nontraditional Student Grant, Dual Enrollment Grant, Helping Heroes Grant, Foster Child Tuition Grant, Rural Health Loan Forgiveness Program, Math & Science Teacher Loan Forgiveness Program, and the Tennessee Student Assistance Award. These figures remain unchanged from those provided to the Board in December 2009.

Fiscal Year	Total TELS Expenditures
2008-09 actual	\$266.6M
2009-10 estimated	\$287.5M
2010-11 projected	\$312.5M
2011-12 projected	\$337.4M
2012-13 projected	\$361.4M
2013-14 projected	\$387.9M

Program expenditure projections are primarily based on increases to the HOPE Scholarship which accounts for approximately 90 percent of overall program costs. Changes in HOPE Scholarship expenditures are largely driven by three factors, two of which increase projected outlays. Recent economic conditions generated significant enrollment increases throughout higher education that are projected to be sustained through 2013-14. Additionally, implementation of the Tennessee Diploma Project is expected to increase the overall academic preparation of high school graduates over the next several years. Finally, projected expenditures for the TELS program are affected by a continuation of the relatively rapid growth in both the Wilder-Naifeh and Dual Enrollment programs.

Please let us know if you have questions or need anything further.